

Adapting to thrive ...

The lessons learned

By Frank Pennachio

Sometimes it takes a dramatic event like the AIG meltdown to alert insurance agencies to the dangers they face—and to opportunities yet to be captured. This is an “Alice-in-Wonderland” moment. What agency possibly could have predicted the world’s largest insurance company could have been so close to bankruptcy?

Things are different and insurance agents need to take a hard look at the sustainability of the business model that served them well for many years. The core business practice of most insurance agencies is to represent insurance companies and secure insurance policies on behalf of their clients. This practice is not likely to change dramatically in the near term, but agents need to wake up to the realities that their world has changed and adapt by offering new business propositions.

A change in mindset is needed to align insurance agencies better with the extraordinary changes occurring within the industry and the world around them. The first step is to eradicate complacency and take a hard look at the threats they must confront. Once these threats are exposed, the next step is to focus on the opportunities to counteract the threats. For every threat, there is an opportunity.

Let’s look at some of the most common challenges. Net premium growth has been soft for more than 20 years, with the exception of a short period from late 2001 to 2003. In addition, despite this protracted soft-insurance cycle, businesses continue to leave the voluntary insurance markets for alternative-risk financing arrangements. The insurance-premium pie is shrinking, and along with it, commissions. So revenue-per-client



is declining, but service demands and expenses continue to rise.

Some insurance agencies are hunkering down and waiting for the next hard-market cycle to shore up their financials. However, the next hard-market cycle may have the opposite effect. Some clients likely will be lost due to the inability to place them with insurance companies who lack capacity. Other businesses, when faced with a spike in insurance premiums, will head for the exits into alternative-risk financing vehicles. When businesses leave the voluntary market, they rarely come back. So, the pie could get even smaller during the next hard cycle.

During the last hard market, many employers were forced to increase retentions or move into captive arrangements. When the market softened, employers whose

loss experience was better than average recognized the benefits of their changes to financing risk; as a result, many of the best employers chose not to reenter the voluntary insurance market.

Another problem insurance agencies face is the inability to differentiate themselves through the insurance companies which they represent. Competitors likely have access to the same insurance companies.

In an attempt to differentiate, many agencies added what they called “value-added services.” The strategy appeared sound. Agents offered additional services, such as loss-control and safety-engineering services, claims support, human resources services, and Web-based tools. The sales pitch went something like this: “If we are close on price and you come with our agency, we will give you this service and that service.”

Naturally, these new services increased the agency's operational costs at a time when the agency was negotiating lower premiums with the insurance company. Policies were being renewed at lower premiums with lower revenue to the agency, but new expenses have been added. It takes significant organic growth to make this strategy work, and there is little evidence that organic agency growth is occurring.

The "value added" approach has not met expectations for other reasons. Too frequently, agents offered services and solutions to businesses that were not even aware of the problems being addressed. The value was not quantified or directed specifically at the pain of the buyer. A value that is not quantified is not a value. These service offerings usually are disregarded, or they just increase the confusion of the buyer.

Incumbent relationships are increasingly difficult to break. A remarkably small percent, around eight to 13 percent, of employers change insurance agencies each year. Business owners simply are not presented with compelling reasons to change, so they stay with their current agent relationship. As a result, agencies engage in too many costly and unproductive sales cycles with no return. When an agency does not succeed in gaining a new business relationship, it typically waits another year to try and recoup the lost dollars spent on the lost opportunity.

Rumors and stories continue to circulate that too many agencies are overly dependent on contingency commissions to attain profits representing a reasonable return on equity. The future of the contingency model remains uncertain. Even if contingencies endure, too much dependence on them puts the agency in the risk business similar to the insurance companies they represent. Is the lion's share of your agency's profits subject to the path of the next hurricane or tornado?

The methods and practices that took insurance agencies to their high point of success in the past are not likely to produce success in the future. There are numerous opportunities within the reach of agencies that can minimize or neutralize their dangers.

The first step to leveraging those opportunities is to recognize the business of the insurance agency of the future is not just to sell insurance policies. Selling and placing insurance policies is just one of the revenue-generating options available to insurance agencies. It is long past time to explore alternative and additional ways to define a relationship with clients and develop multiple streams of revenue separate from commissions.

For example, let us assume your agency is unable to unseat the incumbent and establish a broker-of-record relationship with a business. Is it likely the prospective client still has needs and problems you can take on? Can your agency offer a value proposition that address specifically those needs and problems that produces measurable, positive outcomes?

When a business selects an agent and insurance company, the company usually does not think beyond the transaction of buying insurance into other ways of improving their business. The simple purchase of insurance does not tackle a multitude of needs, risks and problems still residing within the business.

This provides a huge gap for the nonincumbent agent to step into and offer their capabilities, tools and processes to the business on a fee basis. Businesses will pay to make the problems that remain after they buy insurance to go away.

Why don't more agents step into this gap and provide a much needed value to businesses while generating an immediate stream of revenue? Many simply have not seen this opportunity, as they are too busy chasing the next transaction of placing insurance. Others fear the unknown and would rather continue to flail away with the familiar than try something different. Most lack the training and the packaging of ideas and tools to implement such a plan with confidence.

An employer's problems are your opportunities. Are they struggling with too many employees getting hurt and not returning to the workplace? Are they hiring the wrong people? Are they entering into contracts that are potentially destructive to their business? If so, does your organization have or can it get the skill sets to offer them solutions to those problems, and many more for a fee? Human Resource

support, injury management training, contract reviews, and benchmarking are just a few examples of fee-based opportunities awaiting you.

It is critical for independent insurance agencies to uncover and deploy their "hidden assets." Insurance agencies frequently have talented people on board or within their reach that are capable of providing much needed fee-based services to their clients and prospective clients. The future success of insurance agencies may be rooted in moving beyond their core business model and services. Agencies competitive advantages of the past may no longer be enough for the future.

Just like insurance agencies, prospective and current business clients are facing a great many threats. Most of those dangers will not be neutralized by simply purchasing an insurance policy. In addition, businesses are not able to diagnose their own problems, so they are not consciously aware of them or actively seeking solutions. It takes an agent to engage in a dialog with the owner or manager to flesh out their needs and problems that are going unattended or managed.

Protection from dangers and opportunities for growth lie in wait for agents and agencies that are willing to move beyond the transaction approach of placing insurance policies and add fee-based services. Employers will pay upfront and ongoing fees to address their threats and improve their businesses. Agencies have "hidden assets" that can and should be deployed to capture those opportunities. When an employer's problem is uncovered through dialogue, they will practically demand a solution. Why not be ready to provide that solution for a fee regardless if you have placed an insurance policy.

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